

Flexible Spending Accounts

Important Note: *To enable the change to a fiscal year plan year, the State of Colorado Salary Reduction Plan document has been amended to provide for a transitional, six-month plan year (also called the “short plan year” or “period of coverage”) January 1, 2005 through June 30, 2005. The term “plan year” as used in the following section also refers to this six-month plan year. The term “annual election” also means the total contribution for the six-month plan year. During this transitional period only, the maximum annual election (contribution) for Health Care FSA is \$3000, for Dependent Care FSA \$2500.*

What is a flexible spending account and how can it help me control my health care costs?

A flexible spending account (FSA) allows you to set aside money on a pre-tax basis, lowering your taxable income. You can then use that money to cover health care and dependent care expenses. An FSA will not directly lower or control your health care costs, but using an FSA will put more money in your pocket to pay for those costs.

Flexible spending accounts are funded by salary reductions, commonly referred to as “contributions.” You choose the amount you wish to “contribute” each year. This amount is also called your annual election. Your payroll deduction is calculated by dividing your annual election by the number of paychecks you receive in a year. You must make separate elections for your health care flexible spending account and your dependent care flexible spending account.

Central Bank/ ASI administers the State’s FSA plans. You may want to check out ASI’s website at <http://www.asiflex.com>. There is a great deal of detailed information published there. Not all information published on ASI website is applicable to the State of Colorado Plan. Participants may check the status of their flexible spending accounts from the ASI website using the PIN provided on their enrollment confirmations. Alternatively, accounts may be accessed via telephone at 1-800-366-4827. At the prompt, press 2 for balance or disbursement information. Press 1 to speak with a representative.

Are all medical expenses eligible for reimbursement?

No, but most medical expenses not reimbursed by insurance can be reimbursed from your health care flexible spending account. Any expense that qualifies under Section 213(d) of the Internal Revenue Code (except insurance premiums and long-term care expenses) qualifies. You may download Internal Revenue Publication 502 Medical and Dental Expenses from the IRS website at <http://www.irs.gov/pub/irs-pdf/p502.pdf>. The list of eligible expenses changes over time. If you have not reviewed the list recently, you may want to take another look.

Please note that while the IRS requires expenses be “paid” within the tax year (calendar year) to be deductible, expenses must be “incurred” during the plan year in

order to be eligible for reimbursement from a flexible spending account. IRS rules regarding deductions when filing income tax are different.

Important Note: The State's Salary Reduction Plan Document was amended and restated effective June 1, 2004. The plan now allows reimbursement of over-the-counter drugs to treat an existing or imminent medical condition.

Claims Procedures applicable to Over-the-Counter Drugs and Medicines

- The receipt or documentation from the store must include the name of the drug printed on the receipt. This information must be provided by the store, not just listed by the participant on the receipt or on the claim form.
- The participant must indicate the existing or imminent condition on the receipt, on the claim form or on a separate enclosed statement each time these items are claimed. Purchases for general good health will not be accepted.
- To claim vitamins, herbs, or nutritional supplements, you must have a written diagnosis of the medical condition and "prescription" of all specific items for that condition on file with the claims office. You must renew this physician notice every 12 months and file it with the claims office with the first claim submitted for them each plan year.

Non-Qualifying OTC Medicines and Drugs

Items purchased for general health purposes are not covered. Such non-qualifying items include but are not limited to:

- Vitamins
- Herbs
- Nutritional Supplements
- Cosmetic Supplies (e.g., blemish cream)
- Large supply of qualifying items, not for existing or imminent condition
- First aid supplies and medical staples, not for existing or imminent condition (e.g., aspirin, antacid, antiseptic, camphorated oil, etc., purchased to have on hand)
- Band-Aids, plasters or other non-medicines
- General hygiene items (toothpaste, floss, medicated foot powder, dandruff shampoo, deodorant, etc.)

Are all dependent care expenses eligible for reimbursement?

No, but expenses that qualify under Internal Revenue Code Section 21(b)(2) for the Child Care Credit will qualify for reimbursement. If you pay someone to care for a child under the age of 13 or for a family member that cannot care for himself or herself (e.g., a disabled or elderly adult tax dependent) so you can work, the cost of care may be reimbursed from your dependent care flexible spending account. Download Internal Revenue Publication 503 Child and Dependent Care Expenses –

<http://www.irs.gov/pub/irs-pdf/p503.pdf> - for more information. If you file for the childcare tax credit with your tax return, you may still be eligible to participate in the

dependent care flexible spending account, depending upon your income level and the amount of care expenses you expect to incur. You may want to consult your tax advisor before making an election.

How much can I save?

The amount you can save depends upon your tax bracket and the amount of your election. If, for example, your combined federal and state income tax rate is 22%, you will save approximately \$22 in taxes per \$100 of annual election.

Account balances are forfeited at the end of the year. Why can't the money be returned to me?

Flexible Spending Accounts are subject to IRS Section 125 rules and regulations. Under current law, an employer is prohibited from refunding or carrying over an individual's flexible spending account balance from one plan year to the next.

I have heard that Healthcare Reimbursement Accounts can be carried forward.

Despite the similar name and purpose, "Healthcare Reimbursement Accounts"(HRA's) are not the same thing as "Health Care Flexible Spending Accounts" and are not subject to Section 125 of the Internal Revenue Code. One major difference is that Healthcare Reimbursement Accounts are funded with employer contributions while flexible spending accounts are funded with employee contributions (salary reductions). The Healthcare Reimbursement Account is an integral feature of many "defined contribution" medical plans, a type of self-funded plan we are currently investigating.

Can I change my election mid-year?

Maybe. Although the State's FSA plan allows a participant to change his or her election in response to certain "qualifying events," the Section 125 rules and regulations are quite stringent. The proposed change must be consistent with the qualifying event. For example, a request to increase an election would be consistent with an addition to the family (e.g. birth or marriage) whereas a reduction in an election would be consistent with a loss (e.g. divorce or death). Changes permitted under Section 125 may or may not be permitted by the State's FSA plan (the State plan is amended from time to time as the federal regulations change). See the State of Colorado Salary Reduction Plan Document for details.

My wife experienced complications during childbirth and our out-of-pocket expenses were much greater than expected. Can we increase our election to cover the extra expense?

You may increase your election within 31 days of the birth, but your reimbursement will be limited to the annual election in place when the expense was incurred. For example, if your monthly contribution to your Health Care FSA was \$100 prior to the birth, you could be reimbursed for no more than \$1200 for expenses incurred prior to the date your election is increased.